KPMG

On the board agenda

2020 vision for the year ahead

KPMG Board Leadership Centre

Prioritising board agendas will be particularly challenging in 2020 as stakeholder voices continue to drive a sharper focus on how the company is being positioned for the future. Combined with concerns about the economy and political gridlock in the UK, and elsewhere, the year ahead will require a careful balance of near-term focus, mid-term agility, and long-term thinking.

Drawing on insights from our conversations with board directors and business leaders we highlight the issues that boards should keep in mind as they approach and execute their 2020 agendas.

Our approach to geopolitics – strategy and risk

Brexit, growing nationalism, cyber attacks on critical infrastructure, and the threat of military conflict in geopolitical hotspots, combined with an absence of global leadership and the deterioration of international governance, will continue to drive global volatility and uncertainty. As Eurasia Group's founder and president has noted, this environment "will require more investment in scenario planning and stress testing. It also means drawing up contingency plans to shorten supply chains, cutting long-term fixed costs, and limiting business exposure to political relationships that have considerable potential to go south."

Help management reassess the company's processes for identifying the risks and opportunities posed by geopolitical disruption and their impact on the company's long-term strategy. Is there an effective process to monitor changes in the external environment and provide early warning that adjustments to strategy might be necessary? Help the company test its strategic assumptions and keep sight of how the big picture is changing: connecting dots, thinking differently, and staying agile and alert to what's happening in the world. In short, disruption, strategy, and risk should be hardwired together in ongoing boardroom discussions.

For more on the topic of strategy, read the full report 'Facilitating the board's engagement in strategy'

Our approach to emerging and disruptive technology – strategy and risk

As digital technologies such as cloud computing, AI and blockchain continue to advance – both in capability and in application – their impact on risk assessment – both in terms of disruption as well as protection solutions – becomes as increasingly important as it is challenging.

Boards are increasingly aware that most companies' risk management processes are not fully robust – being unable to identify emerging and disruptive risks. Now more than ever is the time to firmly pose questions around this, and just as importantly to follow up robustly on the proposed actions. Are the company's risk management processes adequate to address the speed and disruptive impact of these advances, and to assess the continuing validity of the key assumptions that are the basis for the company's strategy and business model? Tomorrow's competitors are likely to be different than yesterday's.

Where disruptive technology is identified as a risk management opportunity does the business have the right skills to deliver on it? Understanding the risks and opportunities posed by technologies is a long way from being able to actively manage or leverage them which requires skills rarely found in current management but typically prolific within the millennial population.

Our role in society

Corporate growth and shareholder return still require the essentials - managing key risks, innovating, capitalising on new opportunities, and executing on strategy - but the context for corporate performance is changing quickly and, perhaps, profoundly.

Mounting societal issues – such as unemployment, income inequality, the climate emergency, diversity and inclusion – coupled with limited government solutions, continue to heighten expectations for corporations to address the gaps and rethink their responsibility to society.

The 2018 UK Corporate Governance Code (the Code) introduced 'corporate purpose' as a new fundamental principle and many would now accept that a successful company must not only generate value for shareholders, but also contribute to wider society. Similarly, companies who fail to deliver on a sense of purpose will ultimately lose the licence to operate from key stakeholders – as with diversity and inclusion, this is not a political correctness issue, but rather an essential component for sustainable growth.

For many, Company Law (and the Code) now 'requires' that boards should understand the views of key stakeholders and describe in the annual report how their interests have been considered in board discussions and decision making. It's not yet clear how boards will report in practice, but the starting point is likely the identification of both the key stakeholders, how they have been engaged, how the board has had regard to their issues and the impact of that regard on the key decisions made by the board during the year.

Our board – diversity and inclusion

Given the demands of today's business and risk environment, boards must increasingly focus on aligning their own composition with the company's strategy, both today and with a longer term view. The world has arguably changed markedly faster than boards, and the need for relevant experience, diversity and inclusion in the boardroom continue to be front and center for investors, regulators, and other stakeholders. How does your boardroom skills, experience and diversity record fare against the company's own goals, its strategy and its risk profile?

While not yet at the pace required to meet the Government set targets, the number of women on boards is at least moving in the right direction. Unfortunately the same cannot be said for the other widely measured diversity metric – BAME representation. According to the Parker Review Committee "today's FTSE100 and 250 Boards do not reflect the society we live in, nor do they reflect the international markets in which they operate. Whilst we are making good progress on gender diversity in the Boardroom, we still have much to do when it comes to ethnic and cultural diversity". Further, despite the recommendation that each FTSE100 Board have at least one non-white director by 2021 and each FTSE250 board have at least one non-white director by 2024, a recent study by executive search firm Green Park found that "new ethnic minority appointments are barely keeping up with attrition, rather than increasing in number".

The increased level of investor and political engagement on this topic highlights frustration over the slow pace of change in boardrooms, and points to the central challenge with board composition: a changing business and risk landscape. Addressing competitive threats and business model disruption, technology innovations and digital changes, cyber risk, and global volatility requires a proactive approach to board-building and board diversity – which can be measured in so many ways: from race and gender, sexual orientation and disability, to geographical heritage. International diversity is especially important for businesses operating across many different markets. To be part of the solution everyone needs to be informed. Do all members of the board understand complex and compounding barriers that minorities face?

It's clear that board composition and diversity should be a key area of board focus in 2020, as a topic for communications with the company's institutional investors, enhanced disclosure in the annual report, and positioning the board strategically for the future.

For more on the topic of improving gender balance in FTSE leadership, read the full report, 'Hampton Alexander Review'

"The data is available, let's start using it. Why wouldn't everyone ask – how many women leaders are here compared to men, how big is the gender pay gap, what policies promote equal parenting, agile working, and what is the company's purpose beyond shareholder returns?"

Denise Wilson OBE
Chief executive, Hampton Alexander Review

Our culture

Does the company make it safe for people to do the right thing? Headlines of sexual harassment, price gouging, aggressive sales practices, and other wrongdoing continue to put corporate culture front and center for companies, shareholders, regulators, employees, and customers.

Boards themselves are also making headlines – particularly in cases of self-inflicted corporate crises – with investors, regulators, and others asking, "Where was the board?"

Given the critical role that corporate culture plays in driving a company's performance and reputation – for better or, as evidenced by #MeToo, for worse – we see boards taking a more proactive approach to *understanding, shaping, and assessing* corporate culture. Have a laser focus on the tone set by senior management and zero tolerance for conduct that is inconsistent with the company's values and ethical standards, including any "code of silence" around such conduct. Be sensitive to early warning signs and verify that the company has robust whistle-blower and other reporting mechanisms in place and that employees are not afraid to use them.

Understand the company's actual culture (the unwritten rules versus those posted on the notice board); use all the tools available – surveys, internal audit, hotlines, social media, walking the halls, and visiting facilities – to monitor the culture and see it in action. Recognise that the tone at the top is easier to gauge than the mood in the middle and the buzz at the bottom. How does the board gain visibility into the middle and bottom levels of the organization? Make sure that incentive structures align with strategy and encourage the right behaviors, and take a hard look at the board's own culture for signs of groupthink or discussions that lack independence or contrarian voices. Focus not only on results, but the behaviors driving results.

Our approach to data governance

In our conversations with directors, it's clear that many companies need a more rigorous, holistic approach to data governance – the processes and protocols in place around the integrity, protection, availability and use of data.

Boards have made strides in monitoring management's cyber security effectiveness with, for example: greater IT expertise on the board and relevant committees; company-specific dashboard reporting to show critical risks; and more robust conversations with management focusing on critical cyber security risks, operational resilience, and the strategies and capabilities that management has deployed to minimise the duration and impact of a serious cyber breach. Despite these efforts, given the growing sophistication of cyber attackers, cyber security will continue to be a key challenge.

Data governance overlaps with cyber security, but it's broader. For example, data governance includes compliance with industry-specific privacy laws and regulations, as well as new privacy laws and regulations, such as GDPR, which govern how personal data – from customers, employees or vendors – is processed, stored, collected, and used.

Data governance also includes the company's policies and protocols regarding data ethics – in particular, managing the tension between how the company may use customer data in a legally permissible way with customer expectations as to how their data will be used. Managing this tension poses significant reputation and trust risks for companies and represents a critical challenge for leadership.

To help develop a more rigorous approach around oversight of data governance:

- Insist on a robust data governance framework that makes clear how and what data is being collected, stored, managed, and used, and who makes decisions regarding these issues.
- Clarify which business leaders are responsible for data governance across the business – including the roles of the chief information officer, chief information security officer, and chief compliance officer.
- Reassess how the board – through its committee structure – assigns and coordinates oversight responsibility for both the company's cyber security and data governance frameworks, including privacy, ethics and hygiene.

> "The UK is home to world leading businesses but the threat of cyber attacks is never far away. We know that companies are well aware of the risks, but more needs to be done by boards to make sure they don't fall victim to a cyber attack."
>
> *Margot James*
> *UK Digital Minister*

Our talent pipeline

Few board responsibilities are more important than hiring and firing the CEO – a reality that continues to hit the headlines, particularly if the board is caught flat-footed. Given the complex and disruptive business and risk environment, it is essential that the company have the right CEO in place to drive strategy, navigate risk, and create long-term value for the enterprise.

The board should ensure that the company is prepared for a CEO change – planned and unplanned. CEO succession planning is a dynamic and ongoing process, and boards must always be thinking about developing potential candidates and planning for succession should start the day a new CEO is named. How robust are the board's succession planning processes and activities? Are succession plans in place for other key executives?

Clearly linked to the importance of having the right CEO is having the talent required – from the top of the organisation down through the ranks – to execute the company's strategy and keep it on track. Institutional investors are becoming more vocal about the importance of human capital and talent development programmes and their link to strategy. We expect companies will face an increasingly difficult challenge in finding, developing, and retaining talent that is required at all levels of the organisation. Does management's talent plan align with its strategy and forecast needs for the short and long term? Which talent categories are in short supply and how will the company successfully compete for this talent?

More broadly, as millennials and younger employees join the workforce in large numbers and talent pools become globally diverse, is the company positioned to attract, develop, and retain top talent at all levels? Many remuneration committees are focusing on talent development.

Our crisis response plan

Even the best-prepared companies will experience a crisis, and companies that respond quickly and effectively tend to weather crises better. Crisis readiness goes hand-in-hand with good risk management – identifying and anticipating risks and putting in place a system of controls to help prevent crises or mitigate their impact.

We're clearly seeing an increased board focus on cultural risks as well as key operational risks across the extended global organisation – e.g., supply chain and outsourcing risks, information technology and data security risks, etc. Does the board understand the company's critical operational risks? What's changed in the operating environment? Has the company experienced any control failures? Is management sensitive to early warning signs regarding safety, product quality, and compliance?

Help ensure that management is weighing a broad spectrum of what-if scenarios – from supply chains and the financial health of vendors to geopolitical risks, natural disasters, terrorist acts, and cyber threats. Is the company's crisis response plan robust and ready to go? Does it cover different scenarios? Is the plan actively tested or war-gamed and updated as needed? Does it take into account the loss of critical infrastructure – e.g., telecommunications networks, financial systems, transportation, and energy supplies? Does it include communications protocols to keep the board apprised of events and the company's response – and to address the company's stakeholders?

Our response to the environmental crisis

Employee and consumer activism regarding Environment, Social and Governance (ESG) issues are growing exponentially, but none more so than over the question of the environment.

Major institutional investors have long emphasised their expectations for companies to explain how they are addressing environmental issues in the context of long-term value creation, and while the volume of disclosure has certainly increased, action has been limited. Now, as increasingly visible activist groups expand throughout the millennial population and beyond, their voice becomes ever harder to ignore.

> "The eyes of all future generations are upon you. And if you choose to fail us, I say - we will never forgive you."
>
> *Greta Thunberg*

There is a plethora of frameworks for reporting on the issue as well as various climate specific reporting requirements in company law and regulation, so while the volume of information being presented is significant, and growing, ensuring it is focused, relevant, material and comparable is a challenge.

Along side the need for long term planning and retrospective reporting, the importance of short term action must not be underestimated. In May 2019 the UK government declared a climate emergency which while not creating a legal obligation to act does indicate the growing acceptance of what were previously seen as extreme opinions held only by marginal groups. When the UN drafted the International Crimes against Peace during the second half of the twentieth century, ecocide was one of the then five crimes, and was only finally removed from the draft in 1996. So while we may still be some time off any enactment in law, if and when it does come companies must expect pressure for retrospective analysis of whether they did enough to consider the impact of their operations.

Our executive pay policies

Successive governance reforms have gone some way to strengthening and increasing transparency in the UK executive pay framework -in particular the requirement for shareholder approval of executive pay policies every three years. Nevertheless, boards are increasingly in the firing line with investors, the media, Government, proxy advisors and others looking to hold the committee to account when executive pay appears to be disconnected from long-term corporate performance

The executive pay transparency regulations, applicable for accounting periods beginning on or after 1 January 2019, require quoted companies with more than 250 UK employees to publish CEO pay ratios as compared to that of the average UK employee population.

While this is a significant new disclosure, increased transparency alone is unlikely to silence the voice of challenge – indeed it may increase public disquiet. All boards should expect to receive questions on the detail of their executive pay disclosures, in particular those which compare unfavourably to peer businesses within the industry. Does the board understand their own metrics? And how they differ and compare to those of their peer business? Do they understand year on year movements?

Consideration should also be given to the general climate around pay and transparency, which has an increasing focus on fairness with the introduction of gender pay and national minimum wage reporting. Given the direction of travel, broader disclosures are likely to be on the horizon. Being ahead of the game on the topic of balanced pay could position you well for stable and sustainable results.

Our engagement with shareholders

Shareholder engagement continues to be a priority for companies as institutional investors increasingly hold boards accountable for company performance and demand greater transparency, including direct engagement with independent directors. They continue to challenge the board with tough questions around the broad topics in this agenda as well as specifics around their role in company strategy and risk evaluation, and the findings from their own self-assessment.

In order to ensure they have the full picture, boards should request periodic updates from management about the executive level engagement practices: Do we regularly engage with our largest shareholders and understand their priorities? Do they have access to the right people? What is the board's position on meeting with investors? And perhaps most importantly, is the company providing investors with a clear, current picture of its performance, challenges, and long-term vision?

Be mindful of the company's vulnerabilities to activist investors. Activism need not be short-term nor undermine the board's strategic thinking – done properly it can help focus the strategy and drive enhanced corporate governance. Play the role of activists by looking at the company from the outside-in and prompting change from within to benefit shareholders.

As reflected by the 2019 voting trends, strategy, executive compensation, management performance, ESG initiatives and board composition will remain squarely on investors' radar during 2020. We can also expect investors to focus on how companies are adapting their strategies to address the economic and geopolitical uncertainties and dynamics shaping the business and risk environment in 2020.

The KPMG Board Leadership Centre

The KPMG Board Leadership Centre offers support and guidance to non-executive directors, whether managing a portfolio non-executive career or embarking on a first appointment. Membership offers you a place within a community of board-level peers with access to topical and relevant seminars, invaluable resources and thought leadership, as well as lively and engaging networking opportunities. We equip you with the tools you need to be highly effective in your role, enabling you to focus on the issues that really matter to you and your business.

Learn more at www.kpmg.com/uk/blc.

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